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Annual Report 1994

Melville

Satisfying Customers
Through Specialty Retailing

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Company Profile

Melville Corporation is in the business of satisfying customers through its nationwide network of specialty retail store formats in four business segments: prescription drugs, health and beauty care; apparel; footwear; and toys and home furnishings.

Appealing to a broad cross-section of value-conscious consumers, each retail format offers a distinct merchandise assortment and is committed to providing superior value and service to its customers. Our goal is pre-eminence in all areas of specialty retailing in which we compete by increasing market share and return on investment in each of our merchandise categories, while remaining a low-cost provider.

Financial Highlights

($ and shares in thousands, except per share data)			
Operating Results	1994	1993	% Change
Net Sales	$ 11,285,561	$ 10,435,401	8.1
Operating Profit	610,742	623,337	(2.0)
Earnings before Income Taxes and Minority Interests	578,106	599,527	(3.6)
Net Earnings	307,470	331,790	(7.3)
Dividends on Common Stock	160,422	159,686	0.5
Dividends on Preferred and Preference Stock	24,929	25,248	(1.3)
Per Share of Common Stock			
Net Earnings	$ 2.75	$ 3.00	(8.3)
Dividends	1.52	1.52	-
Financial Position at Year End			
Cash and Cash Equivalents	$ 117,035	$ 80,971	44.5
Inventories	2,138,243	1,858,772	15.0
Working Capital	1,007,757	1,091,323	(7.7)
Shareholders' Equity	2,381,605	2,246,846	6.0
Key Percentages			
Operating Profit as a Percentage of Net Sales	5.4	6.0	
Earnings before Income Taxes and Minority Interests as a Percentage of Net Sales	5.1	5.7	
Net Earnings as a Percentage of Net Sales	2.7	3.2	
Return on Beginning Shareholders' Equity	13.7	16.0	
Statistics			
Weighted Average Common Shares Outstanding	105,481	105,069	0.4
Number of Stores	7,378	7,282	1.3
Number of Associates	117,414	111,082	5.7
Number of Common Shareholders	7,200	7,600	(5.3)

MELVILLE AT A GLANCE

($ in thousands)	Net Sales 1994	1993	% Change	Average Store Size Square Feet
Prescription Drugs, Health and Beauty Care				
CVS (a)	$ 4,330,099	$ 3,948,197	9.7	8,800
Apparel				
Marshalls	2,774,851	2,608,542	6.4	31,800
Wilsons	475,123	479,275	(0.9)	2,600
Bob's	288,954	207,400	39.3	46,500
Chess King (b)	–	55,164	(100.0)	–
Accessory Lady (c)	–	45,545	(100.0)	–
Footwear				
Meldisco	1,280,527	1,212,496	5.6	3,200
Footaction	332,294	262,262	26.7	3,200
Thom McAn	226,874	237,578	(4.5)	3,200
Manufacturing (d)	188	757	(75.2)	–
Toys and Home Furnishings				
Kay-Bee	1,012,164	919,054	10.1	4,100
Linens 'n Things	440,118	333,178	32.1	19,800
This End Up	124,369	110,437	12.6	1,100
Prints Plus (e)	–	15,516	(100.0)	–
Melville Corporation				
Total	$11,285,561	$10,435,401	8.1	

(a) Interdivisional sales of $3,478 have been eliminated in 1994.

(b) Reflects its sale as of May 17, 1993.

(c) Reflects its sale as of October 16, 1993.

(d) Interdivisional sales of $4,609 in 1994 and $17,532 in 1993 have been eliminated; operations ceased July, 1994.

(e) Reflects its sale as of May 29, 1993.

(f) Before corporate expenses.

Number of Stores		
1994	1993	% Change
1,328	1,284	3.4
484	448	8.0
628	631	(0.5)
20	16	25.0
–	–	–
–	–	–
2,778	2,771	0.3
439	391	12.3
323	337	(4.2)
–	–	–
996	1,026	(2.9)
145	143	1.4
237	235	0.9
–	–	–
7,378	7,282	1.3

Segment Summary			
	1994	1993	% Change
Prescription Drugs, Health and Beauty Care			
Net Sales	$ 4,330,099	$ 3,948,197	9.7
Percent of Total	38.4	37.9	
Operating Profit	227,655	195,670	16.3
Percent of Total	35.2	30.8	
Apparel			
Net Sales	3,538,928	3,395,926	4.2
Percent of Total	31.3	32.5	
Operating Profit	161,087	181,922	(11.5)
Percent of Total	24.9	28.6	
Footwear			
Net Sales	1,839,883	1,713,093	7.4
Percent of Total	16.3	16.4	
Operating Profit	158,561	168,979	(6.2)
Percent of Total	24.5	26.6	
Toys and Home Furnishings			
Net Sales	1,576,651	1,378,185	14.4
Percent of Total	14.0	13.2	
Operating Profit	99,403	89,138	11.5
Percent of Total	15.4	14.0	
Total Operating Profit	$ 646,706	$ 635,709	1.7

To Our Shareholders

The retail environment, while always dynamic, is undergoing fundamental change that is affecting almost every participant. Dramatic shifts in consumer shopping habits and increasing competition are forcing retailers to constantly reexamine their strategies.

Melville brings significant strengths to this process. Chief among them are the diversity of our portfolio of retail formats and our flexibility to respond to change. We are able to place our resources and energies behind those concepts that are the most suitable to the times and have the best potential for growth. This flexibility has been a critical element of our success in the past, and we believe it will be so in the future.

Melville's performance over the past few years, however, has not been satisfactory. In 1994, our financial results were mixed. Good to excellent performances in several divisions were offset by disappointing outcomes in others. As a result, consolidated net earnings per share declined to $2.75 in 1994 from $3.00 the year before, although consolidated net sales rose 8% over 1993 to a record $11.3 billion.

Eight of our ten divisions achieved increased sales. Two of our four business segments generated higher operating profits: prescription drugs, health and beauty care; and toys and home furnishings. Among the highlights, CVS had an outstanding year and benefitted greatly from its investments in technology. Kay-Bee rebounded strongly in most merchandise categories. Linens 'n Things experienced a significant increase in sales and operating profits due to the success of its superstore format coupled with strong consumer spending in home related categories.

Our apparel segment, however, was impacted by the continuing industry-wide downturn and, despite an increase in sales, experienced a decline in operating profits. In the footwear segment, sales increased at Meldisco and Footaction. Operating profits for this segment were below last year due to higher costs associated with the expansion of the Footaction chain and lower sales at Thom McAn as we continue to reposition this business.

Strategic Review

In late 1994 we initiated a comprehensive strategic review of our organization and our operations to address three main issues. The first is to examine the mix of businesses in the Corporation to determine the proper role of each in generating sales and profits. The second is to ensure that the strategy of each division is appropriate for the role determined. The third is to define clearly how Melville can and should enhance the value it adds to its businesses today.

The objective of this process is to achieve consistent earnings growth and increased returns on shareholders' equity, and we are moving expeditiously to attain this goal. To this end, we have created a new corporate level strategic planning function.

> There is considerable evidence that many of the initiatives made in the past few years are beginning to yield returns.

Although we are not satisfied with our results, there were many signs of strength in our 1994 performance. There was, for example, considerable evidence that many of the investments made in the past few years, particularly in systems, logistics and real estate, are beginning to yield returns.

Stanley P. Goldstein
Chairman of the Board and
Chief Executive Officer

Harvey Rosenthal
President and
Chief Operating Officer

We expect to begin implementing the findings of this strategic review as soon as possible.

Divisional Review

This brief review of each of our divisions illustrates some of the advantages of Melville's diversity and the strengths of many of the companies in our portfolio. Our companies are in several distinct stages of development, from strong and stable, to rapidly growing, to newly reinvented.

Melville has a diversified real estate strategy tailored to each of its businesses. Approximately 81% of our sales volume is generated from locations outside malls, in strip centers or freestanding locations, while the remaining 19% is generated from mall-based stores.

All of our companies are benefitting from a corporate-wide commitment to leading-edge information technologies. New store systems have been implemented at CVS, Marshalls, Wilsons and Thom McAn, which have enhanced our merchandising, distribution and other capabilities and have put us in a stronger competitive position.

Prescription Drugs, Health and Beauty Care

CVS Our largest division enjoyed a very good year as sales increased 10% to $4.3 billion. Gains came from both the pharmacy and the front of the store.

Significantly, operating profits climbed 16% as CVS began to benefit from substantial investments that have been made over the past several years. The assimilation of the 490 Peoples Drug stores acquired in 1990 was completed. All stores have been renovated and linked to CVS' information networks. Meanwhile,

important new computer systems are now in use chain-wide: scanning systems at checkouts and the new prescription management system, RX2000®, in pharmacies. CVS' real estate strategy is to dominate its markets. It will expand aggressively in 1995, opening 75 new stores, more than at any time in its history.

In 1994, we created a new division, PharmaCare Management Services, Inc., which manages pharmacy services and managed-care drug programs. PharmaCare provides coordinated, cost-effective pharmaceutical care with superior customer service and guaranteed results. This exciting new division is already managing prescription drug care for approximately one million lives.

Apparel

Marshalls The prolonged weakness in the apparel market, and especially in the off-price channel, caused a 1% decrease in same store sales at Marshalls. The chain is strongly profitable, however, and its expanded home furnishings and other non-apparel categories performed well, increasing 20% over last year. The apparel industry is experiencing structural change because of shifting consumer buying habits and a growing concentration of competitors, including department stores, factory outlets and others.

Marshalls has begun a major strategic reassessment to determine how it should use its strong consumer franchise to capitalize on these trends. We will begin testing initiatives this year. We are well aware that, for the continued overall growth of Melville, we must take significant action to get Marshalls' earnings back on a positive growth track.

Wilsons Sales declined only fractionally, to $475 million, but Wilsons' operating profits suffered. Higher than usual markdowns were taken because of weaknesses in the outerwear market and unfavorable leather fashion trends. This division's performance contributed significantly to the decline in Melville's earnings; however, we are optimistic that this situation can be turned around. Wilsons has a solid core of stores that prosper during the fourth quarter. Our strategy is to build on this foundation by expanding our seasonal marketing to include holiday kiosks in malls, temporary seasonal stores, leased departments in other stores and mail order catalogues.

Bob's A fast growing division, Bob's is a destination store for casual apparel and footwear, offering excitement, selection and value. Bobs' sales increased by 39% to $289 million in 1994. Significant investments were made last year to strengthen Bobs' organization, systems and infrastructure to lay a solid base for rapid expansion in the years ahead. Four new stores were opened during 1994, and we currently plan to open 12 additional stores in 1995.

> All of our companies are benefitting from a corporate-wide commitment to leading edge information technologies.

Footwear

Meldisco Sales by this chain of leased shoe departments in Kmart's stores climbed 6% in 1994, to $1.3 billion. Meldisco is benefitting from Kmart's company-wide modernization of its shopping environment and the opening of more Super Kmart centers. Meldisco has also upgraded the look of its departments and installed a new inventory management system. In 1994, Meldisco continued its record of stable and consistently profitable performance.

Footaction This chain has expanded rapidly in recent years with 1994 sales increasing 27% to $332 million. In 1995, it will focus on refining its superstore concept, which offers depth and variety in athletic footwear and apparel that differentiates it from its mall-based competitors. By temporarily reducing its new store growth rate in 1995, Footaction will be able to improve the performance of its existing store base and thereby reestablish earnings growth.

Thom McAn Sales declined 5%, to $227 million, reflecting the elimination of the children's and men's athletic departments. No longer a family shoe store, it now offers fashionable, casual footwear for value-conscious adults. Additionally, some 300 unprofitable stores have been closed over the past two years as part of the company's restructuring. The chain continues to reduce its overhead commensurate with its store closings. A major cost savings initiative included outsourcing much of its data processing to our Marshalls division.

Toys and Home Furnishings

Kay-Bee This chain of mall-based toy stores rebounded strongly after a restructuring that closed more than 150 stores over the past two years. It achieved a sales gain of 10%, reaching $1.0 billion, and carries excellent momentum into 1995. It will continue to refine its mall-based stores by adopting new merchandising and design concepts that make shopping easier and more inviting.

The company's new larger-store concept, Toy Works, located in strip centers, continues to show promise and will be expanded.

Linens 'n Things This high-growth business increased its sales in 1994 by 32% to $440 million and we expect Linens 'n Things to achieve annual sales of $1.0 billion within the next several years.

Building on the chain's strength in home textiles, its new, 35,000 square-foot format allows tremendous flexibility in satisfying consumer demand for "Things" for the home. Furthermore, taking advantage of Melville's synergies, This End Up furniture departments are being introduced at some Linens 'n Things stores in 1995.

We are aggressively expanding this chain, closing smaller stores and opening only larger ones. Thus, while the number of stores won't change greatly, we will add almost one million square feet of selling space in 1995.

This End Up Sales grew 13% in 1994 to $124 million as this division's offerings were expanded to include a new mix of accessories and upholstered furniture. The company is exploring new distribution channels to enhance its profitability, such as the rent-to-own market, institutional sales and direct mail, as it continues the growth of its larger store format.

Strengthened Management

Melville's management team, both at divisional and corporate levels, has been substantially strengthened over the past several years. We have recruited a number of experienced industry executives to enhance the expertise and capabilities of our organization.

Among the many appointments, Ann Iverson became President and Chief Executive Officer of Kay-Bee in 1994 and helped spearhead this division's rebound. Robert A. Kemeny became President and Chief Executive Officer of This End Up. In early 1995, Gary L. Crittenden joined the Corporation as Senior Vice President, Corporate Development.

Board of Directors

We welcomed two new members to our Board of Directors in 1994. They are: W. Don Cornwell, Chairman and Chief Executive Officer of Granite Broadcasting Corporation, and William H. Joyce, President and Chief Operating Officer of Union Carbide Corporation.

Three directors will retire from the Board effective April 11, 1995. They are: Hyman L. Battle, Jr., of the law firm of Battle Fowler;

John J. Creedon, former President and Chief Executive Officer of Metropolitan Life Insurance Company; and Theodore Levitt, Edward W. Carter Professor of Business Administration Emeritus, Harvard University Graduate School of Business.

We shall miss their wise counsel and enthusiasm for our business and we wish them happiness in the years ahead.

A Look Ahead

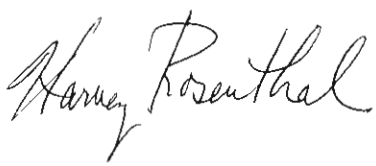
We are committed to enhancing shareholder value. Achieving this objective is an ongoing process that involves continuously improving operating performances as well as implementing major strategic changes where necessary. We have done both in the past and will continue to assess our businesses in that context.

As we think about our strengths going forward, none can compare with our associates, especially the 105,000 in our stores who work with and serve our customers every day. They represent our companies, and we salute them for their outstanding work in an intensely competitive arena.

Our thanks, too, to our shareholders, vendors, landlords and, most especially, the millions of customers who choose our stores.

We believe the future is bright for Melville. We have a group of diverse and exciting businesses. While much progress has been made in attracting and satisfying customers, much still needs to be done. The retail environment will continue to present challenges in 1995, but we are confident in our abilities to develop new strategies and initiatives that will enable Melville to adapt, to compete, and to prosper.

Stanley P. Goldstein
Chairman and Chief Executive Officer



Harvey Rosenthal
President and Chief Operating Officer

February 16, 1995

We believe that the future is bright for Melville. We have a group of diverse and exciting businesses.

We are confident in our abilities to develop new strategies and initiatives that will enable Melville to adapt, to compete and to prosper.

Operating Committee

Melville's Operating Committee helps set future directions for the Company by serving as a forum for exchanging ideas that can be turned into action throughout the organization.

Composed of corporate executives and the Chief Executive Officer of each division, the Committee meets regularly to share information, experiences, best practices and new concepts.

Subjects covered range across the entire spectrum of management concerns, including operating results, inventory management, real estate strategies, market trends, new technologies, employee training and general business conditions.

As individual members share their knowledge of what works and what does not, the Committee facilitates essential change in the organization while also reducing the risks of change. The Committee also acts as an important sounding board for senior executives.

The deliberations of the Operating Committee spark creativity and innovation that quickly impact the way Melville's divisions perform in the marketplace.

Top Row From Left:
Ralph T. Parks
Larry A. McVey
Warren D. Feldberg
Jerald L. Maibrer *
Jerald S. Politzer *
Daniel B. Katz
Norman Axelrod
Joel N. Waller
Michael A. Friedheim
J. M. Robinson

Bottom Row From Left:
Thomas M. Ryan
Robert D. Huth *
Stanley P. Goldstein *
Harvey Rosenthal *
Ann Iverson
Robert A. Kemeny

Not Pictured:
Gary L. Crittenden *

* Member of the Company's Executive Committee.

CVS pharmacy
Just what you're looking for.

CVS' PHARMACY SERVICES INCLUDE THE LATEST TECHNOLOGY, DETAILED INFORMATION ABOUT PRESCRIPTIONS AND KNOWLEDGEABLE, ACCESSIBLE PHARMACISTS.

CVS: Growth Strategies for a Dominant Retailer

Coming off a record year of sales and operating profits, CVS will build on its position as the dominant drugstore chain in much of the Northeast and Middle Atlantic states in 1995. Starting the year with 1,328 stores, CVS is increasing the rate of new-store growth through expansion in existing markets and entry into new markets. It plans to open 75 new stores this year.

CVS is the leader in market share in 20 of the 29 metropolitan markets it serves, and is second in four others. CVS differentiates itself through convenient locations and hours of operation, accessible pharmacy service, an easy-to-shop environment, speed at the checkout, and a store that is well-stocked and well-staffed.

A new pharmacy computer system, RX2000®, was installed chainwide in 1994. The system provides CVS pharmacists with detailed patient information, enhancing its critical role in the healthcare delivery system. The RX2000® database also enables CVS to provide a range of prescription benefit management services to its growing institutional customer base.

CVS' first full year with point-of-sale scanning and satellite technology in the front end is resulting in improved service, better inventory management and in-stock position, fewer markdowns and lower costs. This technology investment also

CVS' CUSTOMERS ENJOY THE ADDED CONVENIENCE OF ITS 24 HOUR STORES, PROVIDING FULL PHARMACY SERVICES WHENEVER THEY ARE NEEDED.

CVS OFFERS A BROAD RANGE OF NAME BRANDS AND PRIVATE LABEL PRODUCTS—JUST WHAT YOU'RE LOOKING FOR.

allows flexible and opportunistic merchandising, and contributes to healthy front end sales growth.

Customer service and community involvement set CVS apart from the competition. The quality of the service delivered by CVS pharmacists, store managers and crew members is crucial to the company's success. CVS conducts a range of communication, training and recognition programs to instill a service ethic throughout the organization.

CVS is the leader in market share in 20 of the 29 metropolitan markets it serves.

In the communities where CVS operates, pharmacists make thousands of health-care presentations to schools, the elderly and community groups. CVS Samaritan Vans patrol the highways assisting stranded motorists, and individual stores seek opportunities to support local activities.

CVS is well-positioned to take advantage of changes in the health-care system and to provide value to its customers.

Marshalls
Never, never, never pay full price.®

FAMOUS NAMES AND EVER-CHANGING SELECTION ARE ONLY TWO REASONS MARSHALLS' MISSES DEPARTMENT IS AN EXCITING PLACE TO SHOP.

MARSHALLS: MERCHANDISING TRUSTED BRANDS AT GREAT PRICES

With 484 stores in 40 states and Puerto Rico, Marshalls is one of the nation's leading off-price retailers. It offers consumers brand-name merchandise for 20-60% less than everyday department store prices. Marshalls emphasizes a wide assortment of trusted brands in apparel and footwear for men, women and children; accessories for women; giftware and domestics.

During 1995, Marshalls will expand and refine programs begun in 1994 to improve its merchandise selection, its communications and its level of service. These initiatives were developed through, and are monitored by, extensive customer research.

New merchandise categories have been added and others expanded to enhance store content. For example, gourmet foods and oriental area rugs are popular new home product

Marshalls' mission is to offer exceptional value, quality and selection in well-known brands.

MARSHALLS' FRAME SELECTION HAS THE BEST-KNOWN STYLES AND DESIGNS WITH PRICES LOWER THAN THOSE OF DEPARTMENT STORES.

MARSHALLS' COLLECTIONS DEPARTMENT CONTINUES TO GROW AS MORE CUSTOMERS BECOME AWARE OF THE TOP NAMES IT OFFERS FOR LESS.

categories. In men's and women's apparel, Marshalls has deepened its commitment to activewear and is devoting increased space and inventory to special sizes. Also, systems have enabled a greater ability for merchandising to appeal to tastes and trends in each market served.

A new advertising campaign using national media to promote chain-wide sales events will be continued in 1995. It has proven to be a powerful way to communicate the chain's mission of offering exceptional value, quality and selection in well-known brands.

Marshalls has also initiated important new store programs that provide up-to-the-minute sales information and release employees from non-selling duties so they can spend more time on customer service.

Its focused real estate program will continue in 1995 when Marshalls plans to open 30 new stores. The chain opened 56 new or relocated stores last year, including 12 in Puerto Rico.

Marshalls' continuing strengths also include close relationships with its many suppliers, approximately 24,000 skilled associates and a low-cost operating structure. All will serve the chain well as it competes in a difficult apparel environment in 1995 and beyond.

MELDISCO

Shoemart at Kmart

MELDISCO'S RUGGED, DURABLE, GENUINE LEATHER TEXAS STEER WORKBOOTS ARE THE BEST SELLING BRAND IN AMERICA.

MELDISCO: PLEASANT NEW ENVIRONMENTS FOR CUSTOMERS

Meldisco, which operates leased footwear departments in Kmart stores, will substantially complete in 1995 a transformation to a contemporary new shopping environment.

The new approach, called Shoemart, simplifies shopping and identifies the department as a modern, value-priced source for all the family's footwear needs. Striking colors and graphics mark the locations of the three major segments of the business: Women's Choice, Kids Parade and Made for Men. Lifestyle photography and improved displays enhance the department.

Surveys show that customers strongly approve of the new Shoemart and better appreciate the quality and value of the footwear. The new look was installed in 1,800 stores in 1994 and will be extended to the balance of the chain this year.

Meldisco also benefits as Kmart adds Super Kmart centers which feature a full line of general merchandise along with groceries. Here, Shoemart receives a better location and more space—3,800 square feet compared to 3,200 square feet in traditional Kmarts. As a result, Meldisco's sales in Super Kmart centers almost double those in traditional stores. There were 67 Super Kmart centers at year end, with 25 more planned for 1995.

"Kids Parade" offers a full range of children's shoes featuring well known brands, like Gerber and Playskool, and the hottest licensed products.

Collections of women's footwear like Jaclyn Smith are coordinated with apparel and accessories to offer busy shoppers head-to-toe fashion options.

Meldisco emphasizes high in-stock levels and outstanding values.

Meldisco emphasizes high in-stock levels and outstanding values in comfortable casual and athletic shoes, work and duty shoes for adults and current fashions for kids. Seasonal assortments for the family—such as winter boots, beachwear and slippers—complete the line.

Meldisco is making significant investments in its merchandising and distribution systems. Substantial cost savings are expected from improvements in its distribution network.

In 1994, Meldisco began conducting marketing programs jointly with major brands such as Spalding, Nickelodeon, Everlast and Franklin. These programs build consumer excitement and draw additional traffic. They will continue in 1995 as a supplement to the principal marketing thrust, weekly newspaper inserts.

A significant reengineering of store operations is underway to streamline or eliminate many functions so that more effort may be devoted to sales and merchandising. A chain-wide roll-out is planned for the second half of the year.

KAY-BEE®
TOY STORES

KAY-BEE OFFERS A HUGE ASSORTMENT OF POPULAR TOYS FOR CHILDREN AS WELL AS GAMES FOR ADULTS.

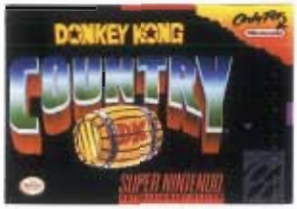
KAY-BEE: BALANCING SALES EXCITEMENT AND SHOPPING EASE

Kay-Bee, one of America's leading toy stores, expects continued sales growth in 1995 from both its mall and non-mall locations.

Kay-Bee is essentially the only toy store in some 900 malls. A new chain-wide merchandising strategy was successfully implemented in 1994, in which Kay-Bee focused on the special value segment of its assortment to create sales excitement and momentum every day. Supported by a well-edited assortment of branded basic and fashion merchandise, it reinforced its message that Kay-Bee takes the guesswork out of toy shopping.

Outside of malls, Kay-Bee expects to open some 30 of its new, 15,000-square-foot Toy Works stores in 1995, bringing the total to more than 70. Consumers are responding well to this new concept. Three times the size of most of its mall stores, Toy Works

Kay-Bee is committed to providing the right store layout to deliver the balance between ease of shopping and a dominant, impactful display.



KAY-BEE HAS THE LATEST SELECTIONS IN VIDEO GAMES AND EDUCATIONAL SOFTWARE.

TOY WORKS

TOY WORKS STORES FEATURE CLASSIC TOY OFFERINGS AS WELL AS BICYCLES, RECREATIONAL EQUIPMENT AND SPORTING GOODS.

features full assortments of children's entertainment and educational items.

In 1995, Kay-Bee is committed to providing the right store layout to deliver that all-important balance between ease of shopping and a dominant yet impactful merchandising display.

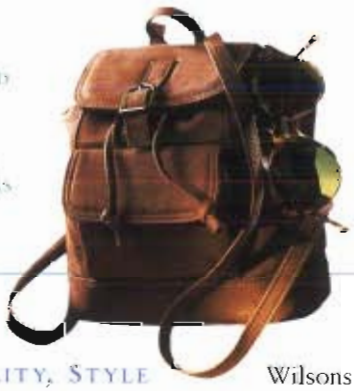
A new distribution system is being integrated with existing procedures for merchandise planning, allocation and replenishment. This gives the chain greater control over the flow of merchandise from vendors. A key benefit, for example, is the ability to detect "hot" items early and arrange more frequent deliveries.

Kay-Bee continues to close underperforming stores, allowing it to focus on its core assets.

New communication systems and new approaches are helping the chain eliminate unnecessary tasks for employees, shifting more of their time to the selling floor. Continuous efforts are made to help employees understand customer expectations and meet or exceed them. For example, a successful chain-wide training program entitled "Train the Trainer" is being expanded. It now covers such subjects as customer service, merchandising, career development, supervision and team building.

WILSONS
THE LEATHER EXPERTS

WILSONS, THE LEATHER EXPERTS, OFFERS A BROAD RANGE OF LEATHER ACCESSORIES FROM PLANNERS AND WALLETS TO BRIEFCASES, BACKPACKS AND HANDBAGS.



WILSONS: QUALITY, STYLE AND VALUE

Wilsons, "The Leather Experts," has 628 stores based primarily in malls. Demand for leather outerwear, its principal offering, has been soft for two years. Not only is the fashion cycle for leather apparel at a low point, but unseasonably warm weather during the fall and early winter sharply reduced demand for coats and jackets in most markets.

Wilsons' strategy for 1995 is to design and manufacture apparel and accessories that are clearly superior to low-priced offerings in terms of quality and style, yet represent obvious value.

The company is also reviewing its retail network to determine the most effective channels of distribution for its products. It is opening a few larger stores that permit more effective merchandising of high margined accessories.

Its plans for the all-important holiday season include out-of-store sales efforts, an expansion of its temporary store or kiosk program and leased departments in selected major retailers.

Wilsons' strategy is to design and manufacture items that are clearly superior to low-priced offerings.

Linens'n Things

LINENS 'N THINGS PROVIDES YOU WITH ALL THE COMFORTS OF HOME BY OFFERING A FULL ARRAY OF DECORATIVE HOME FURNISHINGS AND FASHION ACCESSORIES.

LINENS 'N THINGS: GROWING AS A SUPERSTORE

Linens 'n Things, the leading specialty retailer of fashion home textiles and decorative furnishings, continues to transform itself into a chain of superstores. Linens 'n Things will increase its size by over 25% as it plans to open 30 new 35,000 square feet stores in 1995. By year end, superstores will generate over 75% of the total business.

Linens 'n Things promises wide assortments of quality, brand name merchandise at great values. To help assure all this, a new, automated distribution center will come on-line during the year. This will improve in-stock positions and speed deliveries.

Other investments in technology will simplify receiving procedures and expedite checkouts. All of these improvements allow employees to redirect their efforts into a corporate-wide commitment to improved customer service.

Linens 'n Things continues to differentiate itself by broadening its product offerings. Its strength in decorative home furnishings is balanced by a compelling assortment of housewares and exciting seasonal products.

Linens 'n Things continues to differentiate itself by broadening its product offerings.

FOOTACTION USA

FOOTACTION OFFERS A WIDE SELECTION OF THE TOP BRAND NAMES IN ATHLETIC FOOTWEAR AND APPAREL FOR MEN, WOMEN AND CHILDREN.

FOOTACTION: MOVING TOWARD A UNIQUE IDENTITY

Footaction, a leading retailer of athletic footwear and apparel based in over 400 malls, will continue to expand its successful superstore concept in 1995.

These new Footaction USA stores are three times the size of conventional stores. Their variety of offerings and exciting displays make them a must-see destination for customers who want to explore the constantly changing range of shoes, apparel and accessories available in the marketplace. Footaction will open 10 of these new stores in 1995.

Meanwhile the company continues to attune the merchandising in its traditional stores to create a unique identity. Extensive consumer research and new information systems are aiding this process.

A new automated warehouse came fully on line in 1994, augmented by a new inventory management system and other technological advances. Recognizing the important role of sales associates who are knowledgeable, friendly and efficient, Footaction places special emphasis on recruiting, training and development programs for its associates.

Footaction's variety of offerings and exciting displays make it a must-see destination.

BOB'S STORES
The Original Casual Clothing and Footwear Superstore℠

BOB'S PROVIDES ITS CUSTOMERS WITH A DOMINANT SELECTION OF THE BRANDS THEY LOVE TO WEAR.

BOB'S: BUILDING A NAME FOR VALUE AND SELECTION

Bob's, "The Original Casual Clothing and Footwear Superstore", consistently provides customers with an unparalleled merchandise assortment. In 1995, Bob's plans to open 12 superstores to complement existing New Jersey, New York and New England store clusters and to gain entry into the Philadelphia market. Four superstores opened in 1994.

Bobs' 1995 initiatives include new systems to increase front-end productivity and to improve inventory management. Increased use of events-related marketing will better communicate Bobs' strength in selection and value. Consumer enthusiasm for BCC Blues*, Bobs' private label jeans program, has enhanced the chain's reputation for affordable quality merchandise. BCC Blues* will be developed into a full line of denim-based casual sportswear. Each initiative supports Bobs' mission of exceeding customer expectations, providing value, and offering dominant clothing and footwear selections. By managing business in a simple, cost effective manner, Bob's will work to ensure that key 1995 business objectives of increased market share and profitability are attained.

Bobs' message is strength in selection and value.

THOM McAN
Footwear

THOM McAN'S NEW PRODUCT LINES FEATURE THE FINEST LEATHERS AND OTHER NATURAL MATERIALS PROVIDING COMFORT AND STYLE.

THOM McAN: NOT WHAT YOU REMEMBER

Thom McAn entered 1995 as a distinctly different company after two years of strategic realignment. More than 300 stores were closed and the product offerings were sharply refocused.

Backed by a lively advertising campaign and warm new interior designs, 323 Thom McAn stores offer fashionable, mid-priced footwear for men and women. Consumers are responding favorably to a broadened assortment of quality products for casual, active lifestyles. The prices offer superior value. Thom McAn is perfectly in step with today's fashion pacesetters.

Like many Melville divisions, Thom McAn is benefitting from improvements in technology and computer systems. Information on sales and inventory is more accurate and more quickly available. Delivery time has been reduced. The special inventory needs of individual stores are better served.

Thom McAn's stores are now concentrated in the company's traditional core markets, particularly New England, New York, Florida and Puerto Rico.

Thom McAn is perfectly in step with today's fashion pacesetters.

THIS END UP® FURNITURE CO.

THIS END UP STORES OFFER STYLISH, AFFORDABLE COLLECTIONS OF FURNITURE, ACCESSORIES AND HOME FASHIONS FOR EVERY ROOM IN THE HOUSE.

THIS END UP: NEW DIMENSIONS IN HOME FURNISHINGS

This End Up, a leading mall-based home furnishings center, continues to offer exceptional value with well-designed, high-quality products. Celebrating 20 years of business in 1994, This End Up's evolving line of proprietary products includes its classic design, the more refined Wood's End collection and the new fully-upholstered Lifestyle collection. An extensive designer collection of coordinated fabrics, window treatments, lighting and accessories allow consumers to complete the total look.

By the end of 1995, a significant portion of the company's sales will be generated by the superstore format developed in 1992. This design features classic architecture, columns, slate floors and natural accents to further showcase the new style of This End Up. The company is centralizing the delivery function to improve the flow of product to the customer and reduce paperwork and tasks at the store level, thereby enabling This End Up to continue to meet consumers' expectations for personal attention and unlimited service.

This End Up offers exceptional value with well-designed, high quality products.

Focus on Customer Service

Customer satisfaction is the daily focus in all of our stores. The key strength behind this mission is our people—some of whom appear on these pages. Through their dedication and resourcefulness, we consistently strive to fulfill our customers' needs and to exceed their expectations.

John Watson
Store Manager
CVS
Washington, D.C.

"When faced with a customer service challenge, I first find out what the problem is. Next, I do everything I can so the customer will leave satisfied. Finally, I take the necessary steps to ensure the problem will not recur."

Ben Goldsmith, R.Ph.
Pharmacist
CVS
Boston, MA

"I want each customer to leave the pharmacy with the confidence that he or she has the necessary knowledge to take their medication properly, and the assurance that any insurance payment difficulties are resolved. We serve the special needs of our customers as a team."

Dora Vela
Store Manager
Wilsons
Dallas, TX

"Great customer service is doing what's expected... and then some. It's an upbeat, fun and positive environment with people who enjoy what they do."

Carolyn Kazmi
Store Manager
Linens 'n Things
Denver, CO

"Customers entering a Linens 'n Things store can expect to have an exciting shopping experience in a well-organized, fun environment. They expect to find wide assortments at great prices for all their home decorating needs."

Anthony Powell
Store Manager
Footlocker
Houston, TX

"We place ourselves in the shoes of our customers and recognize service as a broad concept. In this context, the possibilities to provide superior customer service are limitless."

LISA MORAN
STORE MANAGER
MARSHALLS
ANDOVER, MA

"We have a warm store environment staffed with friendly and knowledgeable associates. Our customers can browse easily through a store full of fresh, new and exciting brand name merchandise at everyday prices lower than department store sale prices."

MOHAMAD ATHAR
STORE MANAGER
MEL DISCO
ELMWOOD PARK, NJ

"To meet the ongoing challenge of customer service, I have created a guaranteed size program, empowered my associates to take the steps necessary to satisfy customer needs, and developed a regular customer base. Customer care is our commitment."

LUCY LAZOR
STORE MANAGER
KAY-BEE
HAMMOND, IN

"The pride of my associates at Kay-Bee is reflected in our store's neat and clean appearance, and in the warm and friendly service we provide to our customers."

GINO MONARCA
STORE MANAGER
BOB'S
MILFORD, CT

"We lead by example. Our hands-on management style focuses associates towards exceeding customers' expectations by creating a sense of ownership and pride within each associate."

HARRY BARDOSSAS
STORE MANAGER
THOM McAN
ELMHURST, NY

"We continually gather information through conversations between our sales associates and customers. This feedback allows us to evaluate our current performance versus company standards and customer expectations."

STEPHANIE QUEENSBURY
STORE MANAGER
THIS END UP
YORKTOWN HEIGHTS, NY

"Our Shared Values empower me to make the customer happy. One day that meant personally delivering a storage chest in time for a little boy's birthday party."

Store Expansion

Number of Stores	1994				1995 (Projected)		
	Beginning	Opened	Closed	Ending	Openings	Closings	Ending
CVS	1,284	63	19	1,328	75	20	1,383
Marshalls	448	44	8	484	30	7	507
Meldisco	2,771	159	152	2,778	113	112	2,779
Kay-Bee	1,026	24	54	996	45	27	1,014
Wilsons	631	23	26	628	5	46	587
Linens 'n Things	143	24	22	145	30	21	154
Footaction	391	69	21	439	15	7	447
Bob's	16	4	–	20	12	–	32
Thom McAn	337	6	20	323	3	17	309
This End Up	235	14	12	237	11	10	238
Total	7,282	430	334	7,378	339	267	7450

Financial Statements

Management's Discussion and Analysis of Financial Condition and Results of Operations

Melville Corporation and Subsidiary Companies

Financial Condition

($ in millions)	1994	1993	1992
Cash and cash equivalents	$ 117.0	$ 81.0	$ 145.1
Cash flows provided by operating activities	498.4	435.9	559.4
Daily average of short-term borrowings	567.4	464.8	542.2
Maximum short-term borrowings	948.5	875.0	820.0
Short-term borrowings outstanding at year end	200.0	90.0	–
Net interest expense	32.6	23.8	25.4
Ratios			
Long-term obligations to total capitalization	12.8%	14.0%	15.3%
Long-term obligations to shareholders' equity	14.7%	16.2%	18.1%
Current ratio	1.6	1.8	1.8

The Company's primary source of liquidity is cash provided from its operations. Since 70% of the Company's earnings occur in the fourth quarter, however, it utilizes short-term borrowings, primarily commercial paper issuances, to finance its seasonal inventory needs and capital expenditures throughout the year. Borrowing levels were higher in 1994 as compared to 1993 due to increased capital expenditures while earnings were lower.

Net interest expense is a function of interest rates and short-term borrowing levels. The increase in net interest expense in 1994 relative to 1993 and 1992 reflects higher interest rates as well as higher borrowing levels.

Current assets increased due primarily to a $279.5 million increase in inventories. The increase in inventories is due to new store openings, the early receipt of spring merchandise, opportunistic purchases and increased stock levels required for our larger store formats. Accounts receivable decreased despite higher sales due to the settlement of a disposition related receivable included in the 1993 balance. The allowance for doubtful accounts decreased due to CVS' new pharmacy system, which allows faster verification of third party coverage. Prepaid expenses decreased as utilization of realignment reserves resulted in decreased deferred taxes.

Current liabilities increased due to higher accounts payable and notes payable balances related to the higher inventories. In addition, the timing of payments, particularly the payment of the 1994 ESOP dividends made after year-end, as well as salaries, store rentals and state income taxes led to an increase in accrued expenses.

Capital Expenditures

($ in millions)	1994	1993	1992
Capital expenditures	$ 421.4	$ 386.7	$ 304.3

Expenditures in all years were principally for improvements to new and existing store locations, store equipment and information systems. Capital expenditures for 1995 are estimated at $325.0 million and are primarily for new store openings, continuing improvements to stores and continued investments in information systems and distribution centers.

Results of Operations

($ in millions, except per share amounts)	1994	1993	1992
Net sales	$ 11,285.6	$ 10,435.4	$ 10,432.8
Same store sales increase	3.3%	0.1%	3.2%
Operating profit before realignment charge	$ 610.7	$ 623.3	$ 707.9
Realignment charge	–	–	347.0
Operating profit	610.7	623.3	360.9
Net earnings before realignment charge and accounting change	307.5	331.8	381.4
Net earnings	$ 307.5	$ 331.8	$ 133.4
Net earnings per share before realignment charge and accounting change	$ 2.75	$ 3.00	$ 3.50
Net earnings per share	2.75	3.00	1.13
Percentage of net sales			
Cost of goods sold, buying and warehousing costs	64.3	63.9	62.6
Store operating, selling, general and administrative expenses	28.5	28.3	28.7

Net Sales

Consolidated net sales for the year ended December 31, 1994 were $11.3 billion representing an 8.1% increase over 1993. Sales for the fourth quarter of 1994, which included six fewer selling days than the fourth quarter of 1993, were $3.7 billion, an increase of 4.3% over the prior year. The consolidated operating results, however, exclude those of Chess King, Prints Plus and Accessory Lady after their dispositions on May 17, May 29, and October 16, 1993, respectively.

Adjusting for these factors, consolidated net sales would have increased 9.4% for the year and 4.4% for the quarter. CVS, Kay-Bee, and Linens 'n Things generated positive sales growth throughout the year while disappointing performances at Wilsons and Thom McAn offset these improvements.

Consolidated net sales in 1993 were impacted by the 1993 dispositions and the exclusion of sales of the stores designated to be closed by Thom McAn and Kay-Bee under the 1992 strategic realignment program. Adjusting for these factors, net sales in 1993 increased 4.8%.

Increases in consolidated net sales differ from same store sales increases mainly due to acquisitions, dispositions and store openings and closings. The 1994 increase in same store sales was due primarily to very strong performances at CVS and Kay-Bee offset by poor results at Marshalls and Wilsons. The lower same store sales increase in 1993 resulted primarily from weakness in the apparel and footwear segments.

Net Earnings

Consolidated net earnings for 1994 were negatively impacted by disappointing performances in our apparel and footwear segments, and by costs related to the Company's guarantees for leased properties of businesses sold to purchasers who subsequently filed for bankruptcy protection. In addition to the $5.8 million pre-tax reserve established last year for anticipated lease settlement costs for the remaining Freddy's leases, an additional pre-tax reserve of $17.5 million was set aside, $14.2 million of which was recorded in the fourth quarter, to cover anticipated future obligations. These obligations relate principally to Chess King leases rejected in bankruptcy by Merry-Go-Round Enterprises, the purchaser of Chess King. Management is confident that these reserves are adequate to cover the Company's obligations under these guarantees.

In 1993, net earnings were increased by $10.0 million due to a change in the Company's method of determining retail price indices used in the valuation of inventories valued on a last-in, first-out basis. This was offset by a disappointing performance in our apparel segment, a gross margin decline at CVS and a pre-tax $4.0 million reserve for the loss on sale of the note received in connection with the sale of Chess King.

Under the strategic realignment program formulated during the fourth quarter of 1992, the Company recorded an after-tax, non-cash charge of $222.0 million ($2.13 per share), and elected to record an after-tax, non-cash charge of $22.6 million ($0.21 per share) related to its change in accounting for postretirement benefits.

Net earnings per share declined due to the factors noted above. Adjusted to exclude the impact of the real estate costs, net earnings per share in 1994 would have been $2.86. Adjusted to exclude the impact of the two special charges, net earnings per share in 1992 would have been $3.50.

Strategy Development and Review

At year-end, the Company initiated a comprehensive strategic review, the objective of which is to maximize the Company's sales and profits by examining its mix of businesses.

By the end of 1994, the Company has completed many of the objectives of the 1992 strategic realignment program. To date, the Company has closed over 300 Thom McAn stores, and about 200 of the Kay-Bee and Linens 'n Things stores designated to be closed or converted under the program. In 1993, three divisions, Chess King, Prints Plus and Accessory Lady, were sold and accelerated remodeling programs at CVS and Marshalls were completed. To date, $301.6 million of the pre-tax amount recorded has been utilized.

Costs and Expenses

Cost of goods sold, buying and warehousing costs continue to increase as a percentage of consolidated net sales, reflecting the increased proportion of the prescription drugs, health and beauty care segment to total operations, compounded by continued pressure on third party providers to offer prescriptions at lower prices. In addition, lower initial markon and increased markdowns in our other segments have contributed to the erosion of gross margin.

Store operating, selling, general and administrative expenses increased as a percentage of consolidated net sales in 1994 as compared to a decrease in 1993. The 1994 increase resulted from fixed costs which were not adequately leveraged due to sales shortfalls at several divisions, which offset favorable trends in variable expense categories. Additionally, 1994 included lease settlement costs related to guarantees of Chess King and Freddy's stores sold. Excluding the effect of these one-time costs, the ratio of store operating, selling, general and administrative expenses as a percentage of consolidated net sales was flat with the prior year.

The decrease in the ratio of store operating, selling, general and administrative expenses as a percentage of consolidated net sales in 1993 stemmed from the success of the various cost containment programs underway which have enabled the Company to make significant progress in reducing its variable cost structure.

Accounting Changes

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 112, "Employers' Accounting for Postemployment Benefits", effective January 1, 1994, the impact of which was immaterial.

Effective January 1, 1993, the Company adopted SFAS No. 109, "Accounting for Income Taxes", the impact of which was also immaterial.

In 1992, the Company adopted SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions", and recorded a one-time, after-tax, non-cash charge of $22.6 million to recognize the cumulative effect of the accounting change.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Melville Corporation and Subsidiary Companies

Prescription Drugs, Health and Beauty Care

($ in millions)	1994	1993	1992
Net sales	$4,330.1	$3,948.2	$3,632.1
Operating profit before realignment charge	227.7	195.7	208.6
Operating profit	227.7	195.7	149.2
Percent change from prior year			
Net sales	9.7	8.7	3.0
Same store sales	6.0	5.7	7.7
Operating profit before realignment charge	16.3	(6.2)	1.2
Operating profit	16.3	31.2	(27.6)
Percent of consolidated total			
Net sales	38.4	37.9	34.9
Operating profit*	35.2	30.8	40.3

*Before corporate expenses.

CVS achieved very favorable increases in both net sales and same store sales in 1994. Lower margined pharmacy sales increased 14.7% in 1994 and 24.1% in 1993 due to an expansion of the division's managed care business and the ability of the company to capitalize on its dominant market share. Various micro-marketing initiatives, and an expansion of private label merchandise lines, also helped to increase front store sales.

Net sales in 1993 reflect the success of the "Peoples Celebration Event" launched in late May, 1993 to reintroduce these stores to the Washington, D.C. market. Same store sales increased 7.0% in the fourth quarter of 1993 compared to 6.2% in 1992.

Net sales in 1992 exclude the Freddy's division sold in 1991 and the CVS stores in California sold in February, 1992. Adjusting for these dispositions, net sales would have increased 11.5% in 1992.

Operating profit in 1994 increased despite the larger proportion of pharmacy business as 1993 investments in technology yielded lower operating costs and better inventory control, resulting in lower markdowns.

Operating profit decreased in 1993 due to the impact of increased lower margined prescription sales and incremental costs of rolling out new point of sale and pharmacy systems.

The 1992 realignment charge related principally to the Peoples Drug Stores remodeling program which was completed in 1993.

Apparel

($ in millions)	1994	1993	1992
Net sales	$3,538.9	$3,395.9	$3,486.1
Operating profit before realignment charge	161.1	181.9	230.3
Operating profit	161.1	181.9	125.9
Percent change from prior year			
Net sales	4.2	(2.6)	7.5
Same store sales	(1.5)	(3.6)	3.1
Operating profit before realignment charge	(11.5)	(21.0)	3.3
Operating profit	(11.5)	44.5	(43.5)
Percent of consolidated total			
Net sales	31.3	32.5	33.4
Operating profit*	24.9	28.6	34.0

*Before corporate expenses.

The decline in same store sales for this segment reflects the prolonged nationwide slump in apparel sales, especially the off-price channel, as consumers shifted spending to durables, home related goods and consumer electronics. Underscoring the national trend, Marshalls' gifts and domestics departments experienced a 19.6% increase in net sales while its total sales increased 6.4% over 1993. The expansion of Bob's also contributed to the growth in net sales. Sales decreased at Wilsons for a second year due to weakness in the leather outerwear market which was compounded by overall warm temperatures in fall and early winter.

The 1993 decrease in net sales was due to the sale of Chess King and Accessory Lady and lower net sales at Wilsons. Adjusting for the divisions sold, net sales in the segment would have increased 2.3% in 1993.

Operating profit decreased in 1994 and 1993 because of lower same store sales and gross margins resulting from the heightened promotional activity throughout the apparel industry. This was partially offset by the exclusion of the unprofitable Chess King division and strong control of variable expenses at both Marshalls and Wilsons.

Despite the negative impact of decreased sales and profits at Chess King, operating profit in 1992 before the realignment charge increased due to strong sales at Marshalls, coupled with strict expense control.

The realignment charge recorded in 1992 related to the write-down of certain non-performing assets as well as an estimated loss on sale for the Chess King and Accessory Lady divisions.

Footwear

($ in millions)	1994	1993	1992
Net sales	$ 1,839.9	$ 1,713.1	$ 1,840.0
Operating profit before realignment charge	158.6	169.0	180.0
Operating profit	158.6	169.0	92.0
Percent change from prior year			
Net sales	7.4	(6.9)	5.3
Same store sales	2.4	(2.5)	(1.8)
Operating profit before realignment charge	(6.2)	(6.1)	11.2
Operating profit	(6.2)	83.7	(43.2)
Percent of consolidated total			
Net sales	16.3	16.4	17.6
Operating profit*	24.5	26.6	24.9

*Before corporate expenses.

Net sales increases in 1994 at Meldisco and Footaction were offset by a decline at Thom McAn, resulting from the discontinuation of its men's athletic and children's departments in late 1993 as well as the contraction of this chain.

Net sales decreased in 1993 due to the exclusion from operations of about 390 stores designated to be closed under the strategic realignment program and the discontinuation of product lines. Adjusting for stores excluded at Thom McAn, net sales would have increased 2.2% in 1993.

Net sales increased in 1992 due to the acquisition of Footaction in November, 1991 coupled with a modest sales increase at Meldisco, offset by a decline at Thom McAn. Adjusting to exclude the impact of Footaction, net sales would have decreased 0.1% in 1992.

Operating profit in 1994 decreased due to weak same store sales at Thom McAn, increased markdowns throughout the segment and higher operating costs incurred from the rapid rollout of 32 new Footaction superstores, 27 of which were opened in the second half of the year. In addition, about $5.0 million of one-time costs, principally at Meldisco related to Kmart store closings and other contingencies, negatively impacted profits.

Operating profit decreased in 1993 due to lower same store sales, particularly at Thom McAn, and higher markdowns, which offset an increase in initial markon at Meldisco. Meldisco's direct purchasing program in the Far East and Footaction's success in negotiating more favorable volume discounts, as well as strong expense control, contributed to the increase in operating profit before the realignment charge in 1992.

The realignment charge recorded in 1992 provided for the costs of closing or redeploying about 390 Thom McAn stores. Of the remaining stores designated to be closed, about 50 are planned for 1995.

Toys and Home Furnishings

($ in millions)	1994	1993	1992
Net sales	$ 1,576.7	$ 1,378.2	$ 1,474.7
Operating profit before realignment charge	99.4	89.1	98.1
Operating profit	99.4	89.1	2.9
Percent change from prior year			
Net sales	14.4	(6.5)	7.7
Same store sales	8.3	(2.5)	1.6
Operating profit before realignment charge	11.5	(9.1)	7.3
Operating profit	11.5	2,946.4	(96.8)
Percent of consolidated total			
Net sales	14.0	13.2	14.1
Operating profit*	15.4	14.0	0.8

*Before corporate expenses.

Significant increases in net sales were reported at Kay-Bee, as it enjoyed a strong year in most merchandise categories, and at Linens 'n Things, due to the successful rollout of its superstore format and increased consumer spending in home furnishings and related products.

Sales in 1993 benefitted from strong performances at Linens 'n Things and This End Up, offset by the disposition of Prints Plus and a decrease at Kay-Bee. The 1993 decline at Kay-Bee was due to the exclusion from operations of about 240 stores designated to be closed under the strategic realignment program and the lack of a "blockbuster" toy. Adjusting for the stores excluded and sold, net sales in 1993 would have increased 2.6% over 1992.

In 1992, net sales increased in all of the businesses in this segment except for a slight decrease at This End Up. Adjusting for the effect of K&K toy stores acquired in 1991, net sales would have increased 5.0% in 1992.

Operating profit improved in 1994 because of very strong sales growth and strict control of variable expenses. In addition, a favorable LIFO adjustment offset the decrease in gross margin caused by the implementation of sharper pricing strategies at Kay-Bee early in the year.

Operating profit declined in 1993 due to decreases in same store sales and initial markon at Kay-Bee, offset partially by a pre-tax LIFO adjustment of about $14.0 million and aggressive expense control at all divisions in this segment. Favorable economic trends in the housing industry and an expansion of merchandise offerings at Linens 'n Things and This End Up also contributed to an increase in operating profit before realignment in 1992.

The 1992 realignment charge provided primarily for costs of closing or redeploying about 240 stores at Kay-Bee and converting Linens 'n Things stores to its superstore format. Of the remaining Kay-Bee stores designated to be closed, about 25 are planned for 1995.

Management's Responsibility For Financial Reporting

The integrity and objectivity of the financial statements and related financial information in this report are the responsibility of the management of the Company. The financial statements have been prepared in conformity with generally accepted accounting principles and include, when necessary, the best estimates and judgments of management.

The Company maintains a system of internal accounting controls designed to provide reasonable assurance, at appropriate cost, that assets are safeguarded, transactions are executed in accordance with management's authorization, and the accounting records provide a reliable basis for the preparation of the financial statements. The system of internal accounting controls is continually reviewed by management and improved and modified as necessary in response to changing business conditions and recommendations of the Company's internal auditors and independent auditors.

The Audit Committee of the Board of Directors, consisting solely of outside directors, meets periodically with management, internal auditors and the independent auditors to review matters relating to the Company's financial reporting, the adequacy of internal accounting controls and the scope and results of audit work. The internal auditors and independent auditors have free access to the Audit Committee.

KPMG Peat Marwick LLP, certified public accountants, are engaged to audit the consolidated financial statements of the Company. Their Independent Auditors' Report, which is based on an audit made in accordance with generally accepted auditing standards, expresses an opinion as to the fair presentation of these financial statements.

Stanley P. Goldstein
Chairman of the Board and
Chief Executive Officer

Robert D. Huth
Executive Vice President and
Chief Financial Officer

February 16, 1995

Independent Auditors' Report

To the Board of Directors and Shareholders of
Melville Corporation:

We have audited the accompanying consolidated balance sheets of Melville Corporation and subsidiary companies as of December 31, 1994 and 1993 and the related consolidated statements of earnings, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1994. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Melville Corporation and subsidiary companies at December 31, 1994 and 1993 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1994 in conformity with generally accepted accounting principles.

As discussed in notes to consolidated financial statements, the Company has adopted Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" effective January 1, 1992 and changed its method of determining retail price indices used in the valuation of LIFO inventories in 1993.

KPMG Peat Marwick LLP
New York, New York
February 16, 1995

Consolidated Statements of Earnings

Melville Corporation and Subsidiary Companies

			($ in thousands, except per share data)
Years Ended December 31	1994	1993	1992
Net sales	$ 11,285,561	$ 10,435,401	$ 10,432,843
Cost of goods sold, buying and warehousing costs	7,252,568	6,664,395	6,529,239
	4,032,993	3,771,006	3,903,604
Store operating, selling, general and administrative expenses	3,215,985	2,956,081	2,994,723
Depreciation and amortization	206,266	191,588	201,008
Realignment charge	–	–	346,979
	3,422,251	3,147,669	3,542,710
Operating profit	610,742	623,337	360,894
Interest expense, net	32,636	23,810	25,398
Earnings before income taxes, minority interests and cumulative effect of change in accounting principle	578,106	599,527	335,496
Provision for income taxes	218,741	220,441	125,696
Earnings before minority interests and cumulative effect of change in accounting principle	359,365	379,086	209,800
Minority interests in net earnings	51,895	47,296	53,820
Earnings before cumulative effect of change in accounting principle	307,470	331,790	155,980
Cumulative effect of change in accounting principle, net	–	–	22,551
Net earnings	$ 307,470	$ 331,790	$ 133,429
Per Share of Common Stock			
Earnings before cumulative effect of change in accounting principle	$ 2.75	$ 3.00	$ 1.34
Cumulative effect of change in accounting principle, net	–	–	0.21
Net earnings per share of common stock	$ 2.75	$ 3.00	$ 1.13

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

Melville Corporation and Subsidiary Companies

		($ in thousands)
As of December 31	1994	1993
Assets		
Current Assets:		
Cash and cash equivalents	$ 117,035	$ 80,971
Accounts receivable, net	229,833	243,998
Inventories	2,138,243	1,858,772
Prepaid expenses	165,388	200,290
Total Current Assets	2,650,499	2,384,031
Property, plant, equipment and leasehold improvements, at cost:		
Land	32,917	25,584
Buildings and improvements	222,939	186,025
Fixtures and equipment	1,246,682	1,051,152
Leasehold improvements	687,095	623,403
	2,189,633	1,886,164
Less accumulated depreciation and amortization	674,727	583,964
Net property, plant, equipment and leasehold improvements	1,514,906	1,302,200
Leased property under capital leases, net of accumulated amortization	12,016	14,677
Deferred charges and other assets	109,641	113,455
Goodwill, net of accumulated amortization of $94,987 in 1994 and $81,531 in 1993	448,427	443,678
Total Assets	$4,735,489	$4,258,041

See accompanying notes to consolidated financial statements.

($ and shares in thousands, except per share data)

	1994	1993
Liabilities		
Current Liabilities:		
Accounts payable	$ 660,691	$ 559,469
Accrued expenses	659,502	558,270
Notes payable	200,000	90,000
Federal income taxes	102,008	74,376
Other current liabilities	20,541	10,593
Total Current Liabilities	1,642,742	1,292,708
Long-term debt	331,340	341,763
Deferred income taxes	81,702	83,333
Other long-term liabilities	188,126	198,203
Minority interests in subsidiaries	108,644	93,858
Redeemable Preferred Stock		
Cumulative preferred stock, Series B, $4.00 dividend, par value $100, redeemable at par plus accrued dividends; authorized and issued 17 shares in 1994 and 1993; 4 shares held in treasury in 1994 and 1993	1,330	1,330
Shareholders' Equity		
Preference stock, par value $1.00, authorized 50,000 shares; Series One ESOP Convertible, liquidation value $53.45; issued and outstanding 6,379 in 1994 and 6,499 in 1993	340,948	347,346
Guaranteed ESOP Obligation	(328,096)	(328,570)
Common stock, par value $1.00, authorized 300,000 shares, issued 111,454 and 111,278, outstanding 105,642 and 105,346, net of treasury shares, in 1994 and 1993, respectively	111,454	111,278
Capital surplus	48,122	42,123
Retained earnings	2,494,383	2,364,322
Cumulative translation adjustment	(1,421)	–
Common stock in treasury, at cost; 5,812 and 5,932 shares in 1994 and 1993, respectively	(283,785)	(289,653)
Total Shareholders' Equity	2,381,605	2,246,846
Total Liabilities and Equity	$4,735,489	$4,258,041

Consolidated Statements of Shareholders' Equity

Melville Corporation and Subsidiary Companies

($ in thousands, except per share data)

Years ended December 31, 1994, 1993 and 1992	Preference Stock	Guaranteed ESOP Obligation	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock
Balance as of December 31, 1991	$355,275	$(342,163)	$110,678	$36,563	$2,245,700	$(315,816)
Net earnings					133,429	
Purchase of Series B preferred shares for treasury (237 shares)				7		
Conversion of Series One ESOP Preference Stock through the reissuance of common stock held in treasury (50,358 shares)	(2,692)			223		2,469
Dividends:						
Series One ESOP Convertible Preference Stock ($3.90 per share), net					(15,670)	
Series B preferred ($4.00 per share)					(54)	
Common ($1.48 per share)					(154,530)	
Exercise of stock options and net shares awarded under stock plans			469	16,491		(85)
Conversion of Subordinated Debentures			3	18		
Reduction of Guaranteed ESOP Obligation		6,286				
Balance as of December 31, 1992	352,583	(335,877)	111,150	53,302	2,208,875	(313,432)
Net earnings					331,790	
Reissuance of common stock held in treasury for business acquired (387,110 shares)				(16,459)	149	18,976
Purchase of Series B preferred shares for treasury (75 shares)				3		
Conversion of Series One ESOP Preference Stock through the reissuance of common stock held in treasury (97,987 shares)	(5,237)			434		4,803
Dividends:						
Series One ESOP Convertible Preference Stock ($3.90 per share), net					(16,753)	
Series B preferred ($4.00 per share)					(53)	
Common ($1.52 per share)					(159,686)	
Exercise of stock options and net shares awarded under stock plans			128	4,843		
Reduction of Guaranteed ESOP Obligation		7,307				
Balance as of December 31, 1993	347,346	(328,570)	111,278	42,123	2,364,322	(289,653)
Net earnings					307,470	
Conversion of Series One ESOP Preference Stock through the reissuance of common stock held in treasury (119,696 shares)	(6,398)			530		5,868
Dividends:						
Series One ESOP Convertible Preference Stock ($3.90 per share), net					(16,934)	
Series B preferred ($4.00 per share)					(53)	
Common ($1.52 per share)					(160,422)	
Exercise of stock options and net shares awarded under stock plans			173	5,447		
Conversion of Subordinated Debentures			3	22		
Reduction of Guaranteed ESOP Obligation		474				
Balance as of December 31, 1994	$340,948	$(328,096)	$111,454	$48,122	$2,494,383	$(283,785)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Melville Corporation and Subsidiary Companies

($ in thousands)

Years ended December 31	1994	1993	1992
Cash Flows From Operating Activities:			
Net earnings	$ 307,470	$ 331,790	$ 133,429
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Realignment charge	–	–	346,979
Cumulative effect of change in accounting principle	–	–	37,587
Depreciation and amortization	206,266	191,588	201,008
Minority interests in net earnings	51,895	47,296	53,820
Increase (decrease) in deferred income taxes and other noncash items	1,993	15,595	(93,417)
Change in assets and liabilities, excluding acquisitions and dispositions:			
(Increase) decrease in accounts receivable, net	(15,013)	33,484	(31,728)
Increase in inventories	(266,069)	(86,344)	(25,184)
Increase in prepaid expenses, deferred charges and other assets	(14,123)	(14,392)	(26,239)
Increase (decrease) in accounts payable and accrued expenses	125,849	(125,150)	(10,335)
Increase (decrease) in Federal income taxes payable and other liabilities	100,093	42,016	(26,509)
Net Cash Provided by Operating Activities	498,361	435,883	559,411
Cash Flows From Investing Activities:			
Additions to property, plant, equipment and leasehold improvements	(421,375)	(386,724)	(304,345)
Proceeds from the sale or disposal of property, plant, equipment and leasehold improvements, leased property under capital leases, and operations or assets sold	86,899	97,940	81,655
Acquisitions, net of cash	(36,556)	(41,534)	(25,687)
Net Cash Used in Investing Activities	(371,032)	(330,318)	(248,377)
Cash Flows From Financing Activities:			
Dividends paid or payable	(225,500)	(245,635)	(239,467)
Additions to (reductions of) notes payable	110,000	90,000	(50,000)
Increase (decrease) in book overdrafts	26,931	(6,701)	39,050
Proceeds from the issuance of common stock	3,152	5,799	15,537
Reductions of long-term debt and obligations under capital leases	(4,423)	(13,190)	(9,641)
Effect of currency fluctuation	(1,421)	–	–
Other	(4)	(5)	(49)
Net Cash Used in Financing Activities	(91,265)	(169,732)	(244,570)
Net increase (decrease) in cash and cash equivalents	36,064	(64,167)	66,464
Cash and cash equivalents at beginning of year	80,971	145,138	78,674
Cash and Cash Equivalents at End of Year	$ 117,035	$ 80,971	$ 145,138

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Melville Corporation and Subsidiary Companies

Summary of Significant Accounting Policies

Principles of Consolidation: The consolidated financial statements include the accounts of all subsidiary companies including foreign subsidiaries whose results of operations are not material. The minority interests represent the 49% participation of Kmart Corporation in the ownership of all retail subsidiaries formed or to be formed from July, 1967 until May 1, 1995 for the purpose of operating leased shoe departments in Kmart stores. All intercompany balances and transactions have been eliminated.

Cash and Cash Equivalents: Cash equivalents consist of highly liquid instruments with maturities of three months or less and are stated at cost which approximates market. The Company's cash management program utilizes zero balance accounts. Accordingly, all book overdraft balances have been reclassified to current liabilities.

Inventories: Inventories are stated at the lower of cost or market. Inventories of the retail operations are determined primarily by the retail method with 18.1% valued on a last-in, first-out ("LIFO") basis. Inventories of the manufacturing operations are determined on a first-in, first-out ("FIFO") basis.

Fixed Assets: Depreciation and amortization of property, plant, equipment and leasehold improvements is computed on a straight-line basis, generally over the estimated useful lives of the assets or, when applicable, the life of the lease, whichever is shorter. Amortization of leased property under capital leases is computed on a straight-line basis over the life of the lease. Capitalized software costs are amortized on a straight-line basis over their estimated useful lives.

Deferred Charges: Deferred charges, principally beneficial leasehold costs, are amortized on a straight-line basis, generally over the remaining life of the leasehold acquired.

Goodwill: The excess of acquisition cost over the fair value of net assets acquired is amortized on a straight-line basis over periods not to exceed forty years. Impairment is assessed based on profitability of the related business relative to planned levels and changes in useful life if disposition of a business is expected.

Maintenance and Repairs: Maintenance and repairs are charged directly to expense as incurred. Major renewals or replacements are capitalized after making necessary adjustments in the asset and accumulated depreciation accounts for the items renewed or replaced.

Store Opening and Closing Costs: New store opening costs are charged to expense as incurred. In the event a store is closed before its lease has expired, the total lease obligation, less sublease rental income, is provided for in the year of closing.

Advertising Costs: The Company charges production costs of advertising to expense the first time the advertising takes place.

Federal Income Taxes: The Company and its wholly-owned subsidiaries file a consolidated Federal income tax return. The tax benefit for dividends on unallocated shares of Series One Convertible ESOP Preference Stock ("ESOP Preference Stock") is recorded as a credit to retained earnings.

Accounting Changes: Effective January 1, 1994, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 112, "Employers' Accounting for Postemployment Benefits", the cumulative effect of which was not material to the consolidated financial statements and is therefore not presented separately.

Effective January 1, 1993, the Company adopted SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109"), the cumulative effect of which was also immaterial to the consolidated financial statements and is therefore not presented separately.

In 1993, the Company changed its method of determining retail price indices used in the valuation of LIFO inventories.

Effective January 1, 1992, the Company adopted SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" ("SFAS No. 106").

Postretirement Benefits: The annual cost of postretirement benefits is funded as they arise and the cost is recognized over an employee's term of service with the Company.

Earnings Per Share: Primary earnings per share is computed by dividing net earnings, after deducting net preferred dividends on redeemable preferred stock and the ESOP Preference Stock, by the weighted average number of common shares outstanding during the year.

Fully diluted earnings per share is computed based upon the assumed conversion of the ESOP Preference Stock into common stock. Net earnings are reduced by the difference between the current dividend on the ESOP Preference Stock and the common stock, adjusted for certain non-discretionary expenses based on net earnings.

Foreign Currency Translation: The Company translates foreign currency financial statements by translating balance sheet accounts at the current exchange rate and income statement accounts at the average rate for the year. Translation gains and losses are recorded in shareholders' equity, and realized gains and losses are reflected in income. The balance in the cumulative translation adjustment account of $1.4 million as of December 31, 1994 relates principally to the Company's operations in Mexico. Transaction gains and losses were insignificant.

Reclassifications: Certain reclassifications have been made to the consolidated financial statements of prior years to conform to the 1994 presentation.

Acquisitions

During 1994, the Company acquired the assets of 11 prescription drugs, health and beauty care stores, 12 apparel stores and three stores selling branded athletic footwear and apparel, for an aggregate of $36.6 million in cash. These acquisitions have been accounted for using the purchase method and resulted in goodwill of $17.3 million. Results of operations are included in the consolidated financial statements from their respective dates of acquisition. Pro forma results have not been presented for the effect of these transactions as the operations are not material to the consolidated financial results of the Company.

Strategic Realignment Charge

In 1992, the Company recorded a pre-tax strategic realignment charge of $347.0 million to reflect the anticipated costs associated with a program to close or convert to other formats duplicate or underperforming stores. The charge also included the write-down of fixed assets and other underperforming assets, losses from operations through the expected date of closure or lease settlement, severance and inventory liquidation costs.

Accounts Receivable

Accounts receivable at December 31 consisted of the following:

($ in thousands)	1994	1993
Trade accounts	$ 170,296	$ 216,062
Other	78,395	60,470
	248,691	276,532
Less allowance for doubtful accounts	18,858	32,534
	$ 229,833	$ 243,998

Inventories

Inventories at December 31 consisted of the following:

($ in thousands)	1994	1993
Finished goods	$ 2,131,041	$ 1,849,651
Work-in-process	645	1,616
Raw materials and supplies	6,557	7,505
	$ 2,138,243	$ 1,858,772

Prior to 1993, the Company used the U.S. Bureau of Labor Statistics indices to measure inflation or deflation in the valuation of its LIFO inventories. In 1993, internally developed indices were used to more accurately measure price fluctuations. The net earnings impact of this change on prior years, individually and cumulatively, is not determinable. The change increased 1993 net earnings by $10.0 million.

Had the FIFO method been used, the carrying value of inventories valued on a LIFO basis would have increased by $8.1 million and $22.4 million at December 31, 1994 and 1993, respectively.

Prepaid Expenses

Prepaid expenses at December 31 consisted of the following:

($ in thousands)	1994	1993
Deferred income taxes	$ 97,668	$ 133,362
Other	67,720	66,928
	$ 165,388	$ 200,290

Accrued Expenses

Accrued expenses at December 31 consisted of the following:

($ in thousands)	1994	1993
Taxes other than Federal income taxes	$ 143,801	$ 114,627
Rent	87,811	77,475
Other	427,890	366,168
	$ 659,502	$ 558,270

Short-Term Borrowing Arrangements

Information regarding short-term borrowings outstanding at December 31 was as follows:

($ in millions)	1994	1993
Commercial paper	$ 200.0	$ 90.0
Weighted average interest rate	6.0%	3.3%
Lines of credit available	$ 693.5	$ 630.0
Letters of credit outstanding	433.9	323.4

The Company has available lines of credit with various banks which permit borrowings at prime or other negotiated interest rates. There were no short-term borrowings outstanding under these lines of credit at December 31, 1994 and 1993. The Company can also obtain short-term financing through the issuance of commercial paper and bank loan participation notes, and is not obligated under any formal or informal compensating balance agreements.

Long-Term Debt

Long-term debt at December 31 consisted of the following:

($ in thousands)	1994	1993
Guaranteed ESOP note, 8.52%, payable in various installments through 2008*	$ 340,100	$ 340,100
Other notes and mortgages payable	8,637	8,944
	348,737	349,044
Less current installments	17,397	7,281
	$ 331,340	$ 341,763

*See Employee Stock Ownership Plan footnote.

Notes to Consolidated Financial Statements

Melville Corporation and Subsidiary Companies

A $7.0 million payment for the guaranteed ESOP note was made on January 3, 1995, due to the 1994 calendar. The aggregate long-term debt maturing during each of the next five years is as follows: $10.4 million in 1995, $13.8 million in 1996, $17.5 million in 1997, $21.7 million in 1998 and $13.9 million in 1999.

Net interest expense for the years ended December 31 included the following:

($ in thousands)	1994	1993	1992
Interest expense*	$ 34,113	$ 25,846	$ 26,681
Interest income and capitalized interest	1,477	2,036	1,283
Net interest expense	$ 32,636	$ 23,810	$ 25,398

* Excludes interest related to the guaranteed ESOP note but includes interest costs recognized in connection with the Company's contribution to the ESOP.

Leases

The Company and its subsidiaries lease retail stores and warehouse, plant and office facilities over periods generally ranging from 5 to 25 years with options to renew such terms ranging from 5 to 15 years.

At December 31, 1994, the future minimum lease payments under capital leases, rental payments required under operating leases, and future minimum sublease rentals excluding lease obligations for closed facilities were as follows:

($ in thousands)	Capital Leases	Operating Leases
1995	$ 5,974	$ 505,180
1996	5,650	478,941
1997	5,128	445,175
1998	4,420	406,847
1999	4,264	365,259
Thereafter	12,385	1,711,868
Total	$ 37,821	$ 3,913,270
Less amount representing interest	15,586	
Present value of minimum lease payments	$ 22,235	
Total future minimum sublease rentals	$ 554	$ 43,671

Net rental expense for all operating leases for the years ended December 31 was as follows:

($ in thousands)	1994	1993	1992
Minimum rentals	$ 538,772	$ 496,555	$ 480,505
Contingent rentals	206,906	192,905	207,106
	745,678	689,460	687,611
Less sublease rentals	9,928	6,286	5,085
	$ 735,750	$ 683,174	$ 682,526

Contingent rentals are principally those for leased shoe departments operated under license agreements with Kmart Corporation. These agreements are for terms of 25 years and provide for rental payments based on sales and profits. The remaining terms of license agreements in existence at December 31, 1994 ranged from 5 to 25 years.

The balance of contingent rentals relate to other Company operations and are based only on sales.

Leased property under capital leases at December 31 included:

($ in thousands)	1994	1993
Retail facilities	$ 20,399	$ 25,262
Warehouse, plant and office facilities	21,809	22,603
	42,208	47,865
Less accumulated amortization	30,192	33,188
	$ 12,016	$ 14,677

Contingencies

In connection with dispositions completed in 1991, 1992 and 1993, Melville Realty Company, Inc. ("MRC"), a wholly owned subsidiary of the Company, continued to guarantee rental and other lease-related charges on 501 leases for retail stores and warehouse and office facilities. The present value of these minimum rental payments at December 31, 1994 was approximately $117.7 million. This amount includes $27.5 million related to the sale of Chess King to Merry-Go-Round Enterprises ("MGRE"), which filed for protection under Chapter 11 of the United States Bankruptcy Code. Pursuant to the terms of sale to a third party of a note receivable from MGRE, the Company will be indemnified for 52.5% of costs incurred under any guarantees for the duration of MGRE's bankruptcy. As of February 28, 1995, MGRE has rejected 119 leases guaranteed by MRC, which are not included in the figures above. Although the ultimate liability under these guarantees is uncertain, reserves totaling $15.0 million remain for potential losses as of December 31, 1994.

Stock Incentive Plans

The Company's 1990 Omnibus Stock Incentive Plan (the "Plan") provides for the granting of options, restricted stock and other stock-based awards for a maximum of 5,000,000 shares of common stock to key employees. The Plan replaced the Company's 1973 and 1987 Stock Option Plans and the 1980 Restricted Stock Plan ("Previous Plans").

Stock options under the Plan are awarded at the fair market value on the date of grant. The right to exercise these options generally commences one year from the date of grant and expires ten years after the grant date, provided the optionee continues to be employed by the Company.

The 1989 Directors' Stock Option Plan ("Directors' Plan") for non-employee directors ("eligible directors") provides for the granting of options to purchase a maximum of 150,000 shares of common stock. Any person who becomes an eligible director receives an initial option grant to purchase 2,000 shares of common stock, and, on each January 11 after such initial grant through January 11, 1998, is automatically granted an additional option to purchase 1,000 shares. All options are awarded at the fair value on the date of grant.

The right to exercise options granted under the Directors' Plan generally commences six months from the date of grant and expires ten years after the grant date, provided the director has served continuously during the exercise period.

Information with respect to stock option activity under the Plan, the Previous Plans and the Directors' Plan is as follows:

	Number of Shares	Option Price Range Per Share
Outstanding at December 31, 1991	2,814,640	$ 12.41 / $ 54.75
Granted	717,325	44.63 / 48.44
Exercised	460,090	12.41 / 52.00
Cancelled	44,650	36.00 / 52.00
Outstanding at December 31, 1992	3,027,225	$ 18.19 / $ 54.75
Granted	709,650	41.13 / 53.50
Exercised	126,400	18.19 / 52.00
Cancelled	139,875	39.38 / 52.00
Outstanding at December 31, 1993	3,470,600	$ 18.19 / $ 54.75
Granted	201,000	30.25 / 41.00
Exercised	76,428	18.19 / 39.38
Cancelled	7,000	45.00
Outstanding at December 31, 1994	3,588,172	$ 26.72 / $ 54.75
Exercisable at December 31, 1994	3,399,172	$ 26.72 / $ 54.75

The Plan also permits the granting of performance shares, representing rights to receive cash and/or common stock of the Company based upon certain performance criteria over a three-year performance period, and performance based restricted shares, representing rights to receive common stock of the Company based upon certain performance criteria over a one-year performance period. Compensation expense related to grants under these provisions is based on current market price of the Company's common stock and the extent to which performance criteria are being met.

Information regarding performance shares and performance based restricted shares is as follows:

($ in millions)	1994	1993	1992
Units awarded	77,376	54,301	70,745
Fair market value of units awarded	$ 2.9	$ 2.6	$ 3.4
Shares granted related to units previously awarded	42,051	–	–
Fair market value of shares granted	$ 1.6	$ –	$ –

Restricted stock awards are currently granted under the Plan only in connection with the hiring or retention of key executives and are subject to certain conditions. Restrictions are lifted generally three years after the grant date, provided the executive continues to be employed by the Company. Information with respect to the restricted shares is as follows:

($ in millions)	1994	1993	1992
Shares granted	55,050	2,225	12,265
Fair market value of shares granted	$ 1.9	$ 0.1	$ 0.6
Shares cancelled	1,535	420	2,030

At December 31, 1994 shares available for grant under the Plan totaled 1,959,660 and 68,000 shares of stock were available for grant under the Directors' Plan.

Redeemable Preferred Stock

The Company is required to provide $279,000 annually, on December 1, as a sinking fund to repurchase shares of Series B preferred stock at prices not to exceed $100 per share. Any balance not so applied within one year is returned to the general funds of the Company. The difference between the cost of shares repurchased and par value is reflected in capital surplus.

Notes to Consolidated Financial Statements

Melville Corporation and Subsidiary Companies

Postretirement Benefits

The Company provides postretirement health benefits at several divisions for retirees who meet certain eligibility requirements.

Effective January 1, 1992, the Company adopted SFAS No. 106, and recorded an accumulated postretirement benefit obligation ("APBO") of $37.6 million for active employees and retirees.

The weighted average discount rate used to determine the APBO was 8.67% and 6.90% at December 31, 1994 and 1993, respectively. The following table reflects the accrued postretirement benefit cost as of December 31:

($ in thousands)	1994	1993
Retirees	$ 14,335	$ 19,400
Fully eligible active plan participants	1,987	2,800
Other active plan participants	8,078	12,000
APBO	24,400	34,200
Unrecognized prior service gain	14,163	15,200
Unrecognized net gain (loss)	6,817	(4,000)
Accrued Postretirement Benefit Cost	$ 45,380	$ 45,400

Effective December, 1992, the Company amended these plans to terminate certain benefits, resulting in a prior service gain of $16.7 million to be amortized over 13 years. The net periodic cost recorded for the years ended December 31 was as follows:

($ in thousands)	1994	1993	1992
Interest expense	$ 2,000	$ 2,200	$ 3,300
Service cost	(500)*	(1,000)*	2,100
	$ 1,500	$ 1,200	$ 5,400

* Net of prior service gain amortization.

For measurement purposes, an 11.0% increase in the cost of covered health-care benefits was assumed for 1994; the rate was assumed to decline gradually to 6.0% in 2010, and remain at that level thereafter. A 1.0% increase in the health-care cost trend rate would increase the APBO at December 31, 1994 by $3.1 million, and the 1994 annual expense by $0.4 million.

401(k) Profit Sharing Plan

The Company has a qualified 401(k) Profit Sharing Plan available to full-time employees who meet the plan's eligibility requirements. This plan, which is also a defined contribution plan, contains a profit sharing component, with tax-deferred contributions to each employee based on certain performance criteria, and also permits employees to make contributions up to the maximum limits allowed by Internal Revenue Code Section 401(k). Under the 401(k) component, the Company matches a portion of the employee's contribution under a predetermined formula based on the level of contribution and years of vesting service. Company contributions to the plan for both profit sharing and matching of employee contributions were $18.0 million, $20.3 million and $17.9 million in 1994, 1993 and 1992, respectively.

Employee Stock Ownership Plan

The Company sponsors a defined contribution plan for all full-time employees through its Employee Stock Ownership Plan ("ESOP").

The ESOP Trust (the "Trust") borrowed $357.5 million through a 20-year loan guaranteed by the Company and used the proceeds to purchase 6,688,494 shares of ESOP Preference Stock from the Company. The original liquidation value of the ESOP Preference Stock is guaranteed by the Company. Dividends are cumulative at the stated rate or the common stock rate if higher. Information regarding the ESOP is as follows:

($ in millions)	1994	1993	1992
Dividends paid	$ –	$ 29.6	$ 25.8
Dividends accrued	24.9	–	4.3
Annualized dividends	24.9	25.3	25.8
Tax benefit of annualized dividends	10.0	10.1	10.1
Cash contributions*	11.1	7.9	7.4
Interest costs incurred by the Trust	29.0	29.5	29.8
Compensation expense recognized	5.9	5.7	5.5
Interest expense recognized	5.3	5.9	4.7

* 1994 amount accrued; paid January, 1995.

Contributions to the ESOP, plus the dividends paid on the ESOP Preference Stock held by the Trust, are used to repay the loan principal and interest. The difference between the cash contribution and the aggregate expense recognized is credited to the Guaranteed ESOP Obligation.

Income Taxes

Effective January 1, 1993, the Company adopted SFAS No. 109. The cumulative effect of this accounting change was not material.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities as of December 31 were as follows:

($ in thousands)	1994	1993
Deferred tax assets:		
Employee benefits	$ 66,233	$ 53,915
Inventories	33,956	30,852
Other assets	7,895	21,920
Total deferred tax assets	108,084	106,687
Deferred tax liabilities:		
Property, plant and equipment	92,118	56,658
Net deferred tax assets	$ 15,966	$ 50,029

The provision for income taxes for the years ended December 31 consisted of the following:

($ in millions)	1994	1993	1992
Federal	$ 166.6	$ 170.2	$ 99.1
State	52.1	50.2	26.6
	$ 218.7	$ 220.4	$ 125.7

The provision for income taxes includes net deferred tax charges of $36.2 million and $103.4 million in 1994 and 1993, and a net deferred tax benefit of $97.6 million in 1992. For 1992, deferred income taxes relate principally to costs associated with the strategic realignment program, the capitalization of inventory costs, depreciation, employee related benefits, and leased property under capital leases.

Reconciliations of the effective tax rates to the U.S. statutory income tax rates are as follows:

Percent of pre-tax income	1994	1993	1992
Effective tax rate	37.8	36.8	37.5
State income taxes, net of Federal tax benefit	(5.9)	(5.4)	(5.2)
51% owned subsidiaries excluded from the consolidated Federal income tax return	3.0	2.6	4.4
Goodwill	(0.8)	(0.8)	(3.9)
Other	0.9	1.8	1.2
Statutory income tax rates	35.0	35.0	34.0

Supplemental Cash Flow Information

During the years ended December 31, the Company had the following non-cash financing and investing activities:

($ in thousands)	1994	1993	1992
Fair value of assets acquired	$ 41,832	$ 61,144	$ 26,417
Cash paid	36,578	38,814	25,691
Liabilities assumed	$ 5,254	$ 22,330	$ 726
Book value of common stock issued in pooling of interests	$ –	$ 18,976	$ –
Note received for operations sold	–	29,413	–

Cash payments for income taxes and interest for the years ended December 31 were as follows:

($ in thousands)	1994	1993	1992
Income taxes	$ 140,789	$ 157,240	$ 236,975
Interest (net of amounts capitalized)	34,113	25,747	26,628

Notes to Consolidated Financial Statements

Melville Corporation and Subsidiary Companies

Summary of Quarterly Results

(Unaudited; $ in thousands, except per share data)

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net Sales				
1994	$ 2,379,839	$ 2,507,469	$ 2,737,016	$ 3,661,237
1993	2,033,011	2,537,395	2,355,376	3,509,619
Gross Margin				
1994	$ 800,222	$ 903,227	$ 966,772	$ 1,362,772
1993	694,749	926,835	853,159	1,296,263
Net Earnings (Loss)				
1994	$ (2,505)	$ 45,602	$ 51,718	$ 212,655
1993	(21,686)	74,525	41,504	237,447
Net Earnings (Loss) Per Share				
1994 Primary	$ (0.06)	$ 0.39	$ 0.45	$ 1.97
1994 Fully Diluted *	(0.06)	0.39	0.45	1.90
1993 Primary	(0.24)	0.67	0.35	2.22
1993 Fully Diluted*	(0.24)	0.67	0.35	2.12

*Dilutive effect in the fourth quarter due to the assumed conversion of the ESOP Preference Stock and the seasonality of earnings.

Market Information

Melville Corporation's common stock is listed on the New York Stock Exchange. Its trading symbol is MES. Information with respect to quarterly trading ranges (based on low/high stock prices) and dividends paid per share is as follows:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Year
Market Price Per Share					
1994	$ 35¼-41⅞	$ 37⅞-41⅛	$ 34⅛-39⅞	$ 29¼-36⅞	$ 29¼-41⅞
1993	46¼-54¾	43¾-48¼	42¼-47⅛	38⅞-45⅝	38⅞-54¾
Dividends Paid Per Share					
1994	$ 0.38	$ 0.38	$ 0.38	$ 0.38	$ 1.52
1993	0.38	0.38	0.38	0.38	1.52

Segment Information

The Company is a specialty retailer conducting business through retail stores in four business segments: prescription drugs, health and beauty care; apparel; footwear; and toys and home furnishings. Information about operations for each of these segments is summarized as follows:

($ in thousands)	1994	1993	1992
Prescription Drugs, Health and Beauty Care			
Net sales	$ 4,330,099	$ 3,948,197	$ 3,632,066
Operating profit (a)(b)	227,655	195,670	149,182
Identifiable assets at December 31 (c)	1,662,127	1,592,964	1,492,471
Depreciation and amortization	60,827	56,883	60,233
Additions to property, plant, equipment and leasehold improvements (d)	102,047	104,592	111,802
Apparel			
Net sales	3,538,928	3,395,926	3,486,065
Operating profit (a)(b)	161,087	181,922	125,893
Identifiable assets at December 31 (c)	1,528,693	1,334,026	1,366,191
Depreciation and amortization	79,210	75,963	78,566
Additions to property, plant, equipment and leasehold improvements (d)	145,032	154,247	105,037
Footwear			
Net sales	1,839,883	1,713,093	1,840,022
Operating profit (a)(b)	158,561	168,979	91,984
Identifiable assets at December 31 (c)	660,197	568,015	572,344
Depreciation and amortization	25,911	20,937	22,293
Additions to property, plant, equipment and leasehold improvements (d)	56,503	45,924	26,973
Toys and Home Furnishings			
Net sales	1,576,651	1,378,185	1,474,690
Operating profit (a)(b)	99,403	89,138	2,926
Identifiable assets at December 31 (c)	789,859	655,290	639,764
Depreciation and amortization	37,424	34,797	37,454
Additions to property, plant, equipment and leasehold improvements	92,332	70,948	47,191
Consolidated			
Net sales	$ 11,285,561	$ 10,435,401	$ 10,432,843
Operating profit before corporate expenses (a)(b)	646,706	635,709	369,985
Corporate expenses excluding depreciation and amortization (e)	33,070	9,364	6,629
Corporate depreciation and amortization	2,894	3,008	2,462
Interest expense, net	32,636	23,810	25,398
Earnings before income taxes and minority interests	$ 578,106	$ 599,527	$ 335,496
Identifiable assets at December 31 (c)	$ 4,640,876	$ 4,150,295	$ 4,070,770
Corporate assets	94,613	107,746	131,392
Total assets at December 31	$ 4,735,489	$ 4,258,041	$ 4,202,162
Depreciation and amortization	$ 206,266	$ 191,588	$ 201,008
Corporate additions to property, plant, equipment and leasehold improvements	25,461	11,013	13,342
Total additions to property, plant, equipment and leasehold improvements (d)	$ 421,375	$ 386,724	$ 304,345

(a) Operating profit is defined as total revenues less operating expenses.
(b) In 1992, includes the effect of the strategic realignment charge.
(c) Identifiable assets include those assets directly related to each segment's operations.
(d) Excludes acquisitions.
(e) Includes general corporate expenses as well as net expenses related to other corporate managed subsidiaries. Increase in 1994 relates to lease settlement reserves as well as expansion of centralized services for operating divisions.

Five-Year Financial Summary

Melville Corporation and Subsidiary Companies

($ in thousands, except per share data)

Results for the Year	1994	1993(a)	1992(b)	1991	1990
Net Sales	$ 11,285,561	$ 10,435,401	$ 10,432,843	$ 9,886,183	$ 8,686,765
Wages and Compensation	1,403,401	1,338,881	1,315,564	1,257,756	1,053,440
Taxes	448,890	435,033	318,162	439,272	419,038
Earnings before Income Taxes, Minority Interests and Cumulative Effect of Change in Accounting Principle	578,106	599,527	335,496	640,098	687,338
Earnings before Cumulative Effect of Change in Accounting Principle	307,470	331,790	155,980	346,681	385,261
Net Earnings	307,470	331,790	133,429	346,681	385,261
Dividends Declared	185,351	184,934	180,324	174,517	172,210
Per Share of Common Stock					
Earnings before Cumulative Effect of Change in Accounting Principle	$ 2.75	$ 3.00	$ 1.34	$ 3.20	$ 3.59
Net Earnings	2.75	3.00	1.13	3.20	3.59
Dividends	1.52	1.52	1.48	1.44	1.42
Book Value	22.54	21.33	19.83	20.06	17.99
End of Year Position					
Current Assets	$ 2,650,499	$ 2,384,031	$ 2,429,772	$ 2,359,017	$ 2,103,582
Current Liabilities	1,642,742	1,292,708	1,350,498	1,302,770	1,123,314
Current Ratio	1.6	1.8	1.8	1.8	1.9
Total Assets	$ 4,735,489	$ 4,258,041	$ 4,202,162	$ 4,074,259	$ 3,652,504
Total Long-Term Obligations and Redeemable Preferred Stock	351,762	365,936	376,417	385,483	396,430
Percentage of Long-Term Obligations to Total Capitalization	12.8	14.0	15.3	15.5	17.6
Property, Plant, Equipment and Leasehold Improvements					
Net of Accumulated Depreciation and Amortization	$ 1,514,906	$ 1,302,200	$ 1,207,871	$ 1,105,287	$ 965,085
Capital Additions(c)	421,375	386,724	304,345	253,072	231,132
Percentage of Net Sales					
Earnings before Income Taxes, Minority Interests and Cumulative Effect of Change in Accounting Principle	5.1	5.7	3.2	6.5	7.9
Earnings before Cumulative Effect of Change in Accounting Principle	2.7	3.2	1.5	3.5	4.4
Net Earnings	2.7	3.2	1.3	3.5	4.4
Return on Beginning Shareholders' Equity	13.7%	16.0%	6.4%	18.7%	23.8%
Number of Stores	7,378	7,282	8,213	8,293	7,754

(a) Excludes stores designated to be closed in connection with the 1992 strategic realignment program.
(b) Includes impact of strategic realignment charge.
(c) Excludes acquisitions.

Operations and Officers

CVS
One CVS Drive
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Thomas M. Ryan*
President and Chief Executive Officer

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Warren D. Feldberg*
Chairman and Chief Executive Officer
Jerome R. Rossi
President and Chief Operating Officer

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Mahwah, NJ 07430
J. M. Robinson*
President and Chief Executive Officer

Kay-Bee
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Ann Iverson*
President and Chief Executive Officer

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Joel N. Waller*
Chairman and Chief Executive Officer
David Rogers
President

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Norman Axelrod
President and Chief Executive Officer

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Ralph T. Parks*
President and Chief Executive Officer

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Chairman and Chief Executive Officer

Thom McAn
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Larry A. McVey*
President and Chief Executive Officer

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Robert A. Kemeny*
President and Chief Executive Officer

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Fiorentino (Firenze)
Giorgio Malavolti
President

Melville Realty Company, Inc.
One Theall Road
Rye, NY 10580
Daniel B. Katz
President

Melville Corporation

Stanley P. Goldstein
Chairman of the Board and
Chief Executive Officer

Harvey Rosenthal
President and Chief Operating Officer

Jerald S. Politzer
Executive Vice President

Senior Vice Presidents
Gary L. Crittenden, Acting Chief
Financial Officer
Daniel B. Katz
Jerald L. Maurer

Vice Presidents
James E. Alward
Kenneth A. DellaRocco
Philip C. Galbo, Treasurer
Thomas E. Harms
Robert G. House
Peggy Kelston
William C. Kingsford
John I. Mitchell, Jr.
Arthur V. Richards, Corporate Secretary
Jeffery A. Warzel

Assistant Secretaries
Roger Larence
Edward J. Lucey
Maureen Richards

Assistant Treasurers
Michael L. Mital
Brian M. Szames

* Also a Vice President of the Corporation.

DIRECTORS

Hyman L. Battle, Jr.[1][4]
Of Counsel – law firm of Battle Fowler

Allan J. Bloostein[2]
Consultant – Retail and Consumer Goods Marketing

W. Don Cornwell
Chairman of the Board and Chief Executive Officer of Granite Broadcasting Corporation, a group broadcasting company

John J. Creedon[3][4]
Retired, formerly President and Chief Executive Officer of Metropolitan Life Insurance Company, a personal and group multiline insurance company

Stanley P. Goldstein[3]
Chairman of the Board and Chief Executive Officer of the Corporation

Robert D. Huth[3]
Executive Vice President of the Corporation

Michael H. Jordan[3]
Chairman and Chief Executive Officer of Westinghouse Electric Corporation, a diversified global technology based corporation

William H. Joyce[1]
President and Chief Operating Officer of Union Carbide Corporation, a leading producer of chemicals and polymers

Terry R. Lautenbach[1]
Retired, formerly Senior Vice President of IBM, a multinational advanced information technology company

Theodore Levitt[4]
Edward W. Carter Professor of Business Administration Emeritus, Harvard University Graduate School of Business Administration

Donald F. McCullough[2]
Chairman Emeritus of Collins & Aikman Corporation, a producer of textiles and wall coverings

Harvey Rosenthal
President and Chief Operating Officer of the Corporation

Ivan G. Seidenberg[2]
President and Chief Executive Officer of NYNEX Corporation, a worldwide communications company

Patricia Carry Stewart[5]
Retired, formerly Vice President of The Edna McConnell Clark Foundation, a charitable foundation

M. Cabell Woodward, Jr.[1][2][3]
Retired, formerly Vice Chairman, Chief Financial Officer and a Director of ITT Corporation, a diversified multinational corporation

Francis C. Rooney, Jr.
Chairman Emeritus

(1) Member of the Audit Committee of the Board of Directors of the Corporation.
(2) Member of the Compensation Committee of the Board of Directors of the Corporation.
(3) Member of the Executive Committee of the Board of Directors of the Corporation.
(4) Retiring as of the 1995 Annual Shareholders' Meeting.
(5) Not standing for reelection.

Shareholder Information

Corporate Headquarters
One Theall Road
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(914) 925-4000

Counsel
Davis Polk & Wardwell
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Independent Auditors
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345 Park Avenue
New York, NY 10154

Transfer Agent and Registrar
Chemical Bank
Stock Transfer Department
P.O. Box 3068
New York, NY 10001
(800) 851-9677

Form 10-K
Form 10-K filed with the Securities and Exchange Commission is available without charge upon written request. Requests should be mailed to: Melville Corporate Headquarters, attention of Arthur V. Richards, Vice President and Corporate Secretary.

Annual Meeting
Annual Meeting of Shareholders will be held at Melville Corporate Headquarters, One Theall Road, Rye, NY 10580 at 10:00 A.M., on April 11, 1995.

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Social Responsibility

Our focus in charitable giving is to invest our resources—both human and financial—in efforts to strengthen our nation's education system through participation in a few carefully designed initiatives. We are seeing some exciting returns on these "investments" in the workforce of tomorrow.

Melville has provided seed grants for school improvement initiatives that are now leveraging resources from other companies and foundations, based on their initial success. Some of the grassroots efforts sponsored by Melville divisions are beginning to serve as models to be expanded or replicated elsewhere. We are also proud to announce that one of Melville's initiatives—a national series of televised workshops designed to help schools restructure—recently received recognition as one of ten programs to receive a prestigious Innovations Award from the Ford Foundation.

Our associates continue to become more and more involved with schools and other organizations, offering time and talent in ways that are having a significant impact. This year, starting with five of our divisions, Melville will begin to offer "Melville Challenge Grants" to schools and organizations where associates actively volunteer.

Melville Corporation
One Theall Road
Rye, NY 10580